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As I write this, the market is buoyed today (May 19th) by an upbeat outlook and positive earnings from Hewlett Packard; in addition, earnings for the first quarter overall rose by 27.1%, nearly double analysts' forecasts back in January. However, in the last few months, the stock markets have not reflected the positive news. Why is that?

Other indications that the economy is improving include recent news of surprising employment growth, including 288,000 nonfarm jobs in April. Unemployment is down from 5.7% to 5.6%, and productivity continues to increase. In fact, some observers are saying that the jobless recovery has now ended and a full-fledged recovery is commencing. So, once again, why has the Dow dropped 7.5% since reaching its peak on February 11th?

One answer is that the jobs data, which is good news to most people, is viewed differently on Wall Street. The jobs figures were so positive that the fear is it will result in the economy heating up more than desired, i.e. higher inflation. When that happens, the logic goes, the Federal Reserve Board (Alan Greenspan) may jump in sooner than previously expected to begin raising interest rates in order to, in effect, put the brakes on the economy.

It has been the consensus that the Fed will begin raising rates in August, However, when the jobs report came out last week, the bets were placed on June as a more likely expectation. The trouble is that when rates rise, sometimes

that's not a positive thing for the stock market, since higher rates result in increased financing costs for businesses.

In addition, the markets have been roiled by the cost of crude oil soaring recently to above \$41 per barrel, for the first time in 13 years. This could be another factor, the thinking goes, which may contribute to higher future inflation. In combination with rates moving higher, many observers think that may put a cap on the stock market.

So what we've been seeing is euphoria that we're in the sweet spot of the corporate profit cycle, coupled with anxiety about imminent rate hikes. It's enough to make our heads spin!

Now that we understand what may be happening, what should we, as investors, be doing? Well, my answer is: not too much. Certainly the Fed has no choice about raising rates and that may cause the markets to slump further. But historically, the markets have tended to rebound, once the rate hikes are completed. It's dicey business to consider jumping out for the rate hike period and then jumping back in when you think the Fed is finished. You could miss the timing on those events by a mile. Better to just ride out the turbulence, and use any significant drops as an opportunity to put idle cash to work.

Sincerely,
Chris Kuehne